THE NATIONAL CITY BANK OF NEW YORK

1934

Economic Conditions
Governmental Finance
United States Securities

New York, June, 1934

General Business Conditions

THE Spring rise of business evidently passed its peak about the first of May, and the trend since has been moderately downward. It is usual for a decline in industrial activity to get under way in May, running until August, and the recession therefore is partly seasonal in character. However, it also reflects the passing of special influences which had helped to make the rise after the first of the year more pronounced than usual, and had caused production temporarily to run ahead of consumption in some industries.

Such influences were apparent in both the automobile and steel industries, which were the leaders of the upward movement in the early Spring. Field stocks of automobiles at the beginning of the season were far below requirements, and there was every inducement, in view of the natural business improvement, the disbursement of Government funds to farmers and others, and prospective labor troubles, for manufacturers to build up their dealers' stocks as rapidly as possible. Hence, with some exceptions, production during the first four months exceeded sales by more than the customary margin. By the end of April dealers were once more well supplied. Moreover, sales reports have been less satisfactory. Most companies made less than the expected Spring gains after the higher prices were put into effect in April, and preliminary estimates for May show a decline. For both reasons curtailment of output has followed during May.

In the steel industry the temporary stimulating influence was the price advance announced at the beginning of April, which brought in heavy buying during the period before the new prices took effect. Operating on these orders, mill output expanded from 43.3 per cent of capacity in the first week of April to 56.9 in the second week of May, which may have marked the peak. Buyers in many cases covered requirements well into the third quarter, and in filling these contracts production evidently is outrunning consumption. Hence there are stocks to be absorbed, and with automobile takings falling off, a more than seasonal curtailment in July and August is in prospect.

In the lighter industries making goods of every-day consumption there is also evidence that the expansion earlier in the year was overdone. The cotton mills, whose unfilled orders have been steadily declining, have followed the example of the silk mills in adopting organized curtailment, under direction of the code authority and with the approval of General Johnson. The silk mills closed entirely for one week in May; the cotton mills will reduce machine hours by 25 per cent for twelve weeks beginning June 4. The rayon industry has continued to slow down, and yarn prices have generally been cut 10 cents a pound, following the reduction initiated by one company in April. Wool goods sales have been light and operations are at a very moderate rate, though the Fall goods season should soon be getting under way.

Summer Recession Generally Expected

With industrial curtailment so uniform, the likelihood that the recession will last well into the Summer is generally conceded. Not much in the way of improvement is looked for until the crop movement and preparations for Fall and Winter trade supply their usual fresh stimulus.

Another factor in the recession is the drouth news from the grain States. The possibility of a loss of farm purchasing power through crop failure has slowed up both retail and wholesale trade in the areas worst affected, and naturally leads to business hesitation elsewhere. The situation is disastrous in the Spring wheat belt, and generally serious over the North Central area, though in other regions the damage may not be irrecoverable.

Trade figures in general have not been impressive. Department store dollar sales in New York City for the first half of May were 6.4 per cent above a year ago, including liquor, and 4.2 per cent excluding liquor. This gain

45

compares with an increase of 28.8 per cent in prices, according to the Fairchild index; and although the two percentages are not closely comparable, since demand tends to shift to cheaper goods as prices rise, their wide divergence indicates that the volume of merchandise sold is smaller. Merchants' testimony is generally to that effect.

Over the country sales undoubtedly make a better showing than in New York, particularly in the South and, except in the drouth areas, in rural trade generally. In four weeks ended May 21 the largest mail order house showed a gain of 30 per cent, compared with 28 in the preceding four weeks. Otherwise figures later than April are not available.

Influences on Purchasing Power

The current declines in industrial operations, insofar as they are a natural offset to the preceding rise, should not be greatly disturbing to business sentiment. Such fluctuations are inevitable. General forward movements of business induce over-buying, over-production, and other mistakes of judgment, and it is the usual thing for a reaction to take place after an upswing of five to six months. Moreover, a decline in the indexes during the Summer to levels below one year ago, which is plainly to be expected, will mean little, in view of the special stimulating factors last year.

Nevertheless, there is unquestionably a feeling of disappointment that trade has not been more vigorous, and that purchasing power has not appeared in the markets in the degree that merchants hoped for. Much of the improvement both last year and this began on the farm, and the Department of Agriculture, which makes monthly calculations of farm income, is not encouraging in its latest statement. It estimates April income, including benefit payments, at $300,000,000, compared with $311,000,000 a year ago, and considering that the upward movement had hardly begun in April last year the comparison is wholly unfavorable. The Department also states that farm income during the next few months is "not likely to exceed that of the corresponding months last year," which will be recognized as a conservative opinion in view of the active demand for cotton, wheat and other farm products in June and July last year at, in some cases, higher prices than today.

Moreover, the farmer not only may have fewer dollars to spend but each dollar will purchase less, in view of the 20 per cent advance in the prices of goods the farmers buy, as shown in the Department's indexes. The farmer has enjoyed a great rise of income from March, 1933, through March, 1934, but obviously there is a limit to the practicability of increasing total income by reducing output; and when the rise stops the farmer will have the increase in industrial prices to offset his gains. The industries must take account of this situation.

The second important factor in the outlook is the backwardness of the construction and other capital goods industries, which are the chief areas of unemployment and depression. During the first half of May building contract awards, as reported by the Dodge Corporation, declined 8.4 per cent below the April average, which in turn was 20 per cent below March. Ordinarily there is little seasonal change in this period. Residential building was lower than in April or in May, 1933, but the increase in public works was sufficient to raise total contracts 50 per cent over the same period last year.

The new house renovating program before Congress is calculated to be helpful in the building situation if workmen can be found to do the work for what consumers can pay. According to past experience the plan is sound on its credit side, but the cumulative effect of the codes in the building, materials and supply trades, and the price advances, has been to raise the cost of such work by 40 per cent above the bottom, according to a calculation made for the New York area. The question is whether home owners have had increases in income that will enable them to pay these costs, and if not whether the costs can be reduced. In short, it is a question of the remuneration of the building trades relative to that of all other occupations. If there is not a fair and sound balance between them the building trades will continue to suffer unemployment.

Fundamental Factors in the Outlook

All inquiries into the business outlook come in the end to these familiar questions of cost and price relationships within the economic system, and of the handicaps which are prolonging unemployment in the capital goods industries, and hence depriving the consumers' goods industries of a part of the market they need to sustain their operations. The questions are not new, but they are fundamental to the progress of recovery. The economic situation is plainly out of balance as long as the capital goods industries are not giving their accustomed share of employment, and the building figures above show how little all the efforts to stimulate capital goods activity are contributing to the support of business. It is incontrovertible that the activity of these industries depends upon private enterprise, and that in turn upon confidence of business men and investors in the future, and upon the general state of business and of earnings.

The stage of the recovery movement which everyone desires to reach is the stage at which the "priming of the pump" will come to an end,

and private enterprise will take over and carry on. Plainly that stage has not arrived. There is distrust of the ability to keep goods, priced in relation to the higher costs that have been enforced, moving over the retail counters. There is apprehension of disrupting changes of policy, or of unforeseen complications, in many features of the recovery program. The labor troubles are disturbing evidence of the fact that efforts to restore order in the economic system by exercise of overhead authority may bring new disorder, for one-half to three-quarters of the strikes reported have originated in questions as to methods of collective bargaining; or in other words, what methods of settlement shall govern in the future if and when real controversy does arise.

All business men are conscious of these impediments to recovery, and it is to their credit, and an important factor in the situation, that their morale continues good. Indeed, the argument that the natural forces of recovery, based upon the wants of all human beings for more things than they have and upon the credit improvement, will overcome all impediments, is a strong one. The belief that experimental measures will be modified or abandoned as they are discovered to be ineffective or harmful likewise has good ground, and is a reason for optimism.

On the other hand, the assumption that the Government will keep business going through its expenditures, if natural forces do not suffice for recovery, is a false basis for confidence. It is true that Government expenditures can overcome the lack of sound economic relationships as long as they are large enough, but the longer they are required to keep trade going the more reason for dissatisfaction with the situation and apprehension as to the outlook. Heavy Government expenditures and private enterprise freely nourished by private capital do not readily exist side by side, and the paramount problem is to restore the latter.

Money and Banking

The unusually low level of money rates was continued last month as the excess reserves of member banks remained around their record high figures. There was no change in the nominal rates of 1 per cent for call loans, ¾ to 1 for time loans and $\frac{3}{16}$ for bankers acceptances, while commercial paper bearing the best names was quoted at ¾ to 1 per cent, the lowest ever recorded in this country.

The principal factors this year in these conditions of extreme monetary ease have been the return of currency to the banks, gold imports and the creation of credit by the Treasury through issuing gold certificates to the Reserve Banks. Since the devaluation of the dollar on February 1, the Treasury has put approximately $510,000,000 of gold into use in this way, of which $200,000,000 was charged against the Stabilization Fund set up from the profit on devaluation, and the remainder against the gold in the general fund.

Member bank reserves have advanced steadily since the first of the year, and on May 23 were at peak for the period. Inasmuch as deposit liabilities have failed to increase in the same proportion, the excess reserves have practically doubled and now amount to $1,800,000,000.

Notwithstanding the further increase in bank reserves during the past month, the loans and investments of the weekly reporting member banks have shown some decrease, except in holdings of United States Government securities which showed a slight increase. Loans for commercial and miscellaneous purposes declined to a new low point for the year, reflecting the slack demand on the part of borrowers having satisfactory credit standing and financial responsibility. The total volume of bank credit, however, remains approximately $700,000,000 higher than at the beginning of the year, an increase which is more than accounted for by purchases of Government securities. Bank deposits during the past month have increased slightly and are $1,800,000,000 higher than on January 1.

As a consequence of the mounting supplies of excess reserves there has been a continued concentration of funds into high-grade bonds, and particularly into Government securities. Yields on the Treasury Certificates and Notes, which run up to five years, have all been driven below 2 per cent. The entire list of Liberty Bonds and Treasury Bonds is now selling above par, with many issues establishing new high prices in May. Treasury Bill offerings during the month also set new low discount rates of 0.06 per cent per annum for the 91-day maturity and 0.13 for the 182-day maturity.

The Agricultural Situation

The season is not sufficiently advanced to permit more than a preliminary survey of crop prospects, but the start, in the north central and western States ordinarily having two-thirds of the total crop acreage, has been a poor one. Generally speaking, this area has had subnormal moisture for several years past. The Spring wheat States especially suffered from drouth in 1931 and again in 1933, and these drouths left a deficit of subsoil moisture which has made the shortage of rain thus far this year a very serious matter. In many areas the crop had to be seeded in dust. The situation with respect to pasture is equally bad; the average condition of pastures on May 1, as reported by the Department of Agriculture, was the poorest in fifty years, and the lowest figures are not

only in the Plains country, but in some of the chief dairy States to the eastward.

A feature of the weather news during May has been a number of great dust storms, due to the powdery condition of the soil in certain areas. This signifies soil drifting and blowing out of seed on an unusual scale. It is not far-fetched to describe this soil drifting as a consequence of the World War. But for the uneconomic stimulation to agricultural production given by the war, great areas of the crop land affected would doubtless still be in sod, conserving its moisture and fertility. Moreover, there is irony in the fact that the soil which is wasting would, if it produced this year, make only an unneeded and price-depressing addition to the crop totals.

Wheat Prospects

Under average yield conditions the Spring wheat States would have been expected to produce about 240,000,000 bushels this year. As late as May 15 there was still a possibility of producing up to 200,000,000, with average rainfall thereafter, but as the drouth has continued the prospect now is substantially smaller. Moreover, the Winter wheat crop has also been affected. The drouth extended into Western Nebraska and Kansas, and while on April 1 the Crop Reporting Board expected 492,000,000 bushels of Winter wheat the May 1 estimate was 461,000,000, and later views are somewhat below that figure.

This is a substantial change in the wheat outlook as it appeared about six weeks ago when Secretary Wallace was warning the market that United States and world prices would have to come closer together, partly through a decline in our quotations. Then it appeared that our crop might exceed the domestic consumption, estimated at 625,000,000 bushels, by 75,000,000 bushels and upward; but unless Spring wheat conditions improve greatly the outturn now will be well below domestic requirements.

To be sure, there is no prospect of a shortage of wheat. The carryover on July 1 will be 250-275 millions, according to the Department of Agriculture, and a crop even 50,000,000 below our needs would leave the reserves above what has been considered ample in the past. Moreover, the advance on the drouth news has carried the Chicago price once more to 25 or 30 cents above Liverpool and 20 to 22 above Winnipeg, and with the premiums established at these levels the limit to which domestic quotations can rise independently of the world markets is not far off. Hence the prospect for further improvement, and even the maintenance of the present price, will be influenced increasingly by the world situation.

However, the change in the crop prospect obviously diminishes the likelihood that wheat prices east of the Rockies will fall to an export basis. A larger annual carryover than was formerly thought necessary now seems desirable, for the poor outturn in the Plains areas in three of the past four seasons is warning of the fluctuations to be expected, now that so much of our wheat is produced in regions of unreliable rainfall.

Present indications are more favorable for world prices. The weather has been dry in Canada and in the Danube countries, and the acreages to be harvested in both are smaller. The importing countries of Europe on the whole have smaller crops than in 1933. Early reports suggest a 10 per cent reduction in acreage in Australia. Hence there is considerable hope that prices will rule higher in the coming season in terms of gold, which would signify a genuine improvement in the wheat situation.

The Corn-Hog Situation

The Corn Belt is considerably affected by the drouth, but at this time there is no reason to expect the consequences to be as serious as in Spring wheat. Moisture for germination has been sufficient for the most part, and though the crop is late and the outlook inauspicious conclusions as to the prospective damage would be premature.

The position of the cash corn market is an interesting one. The Government has made loans of 45 cents a bushel on about 270,000,000 bushels which are sealed in farm cribs. If the loan is not repaid by August 1 the corn will become the property of the Government. It now appears that the natural readiness of the corn-hog farmers and cattle feeders to eat their cake and have it led many of them to underestimate their feeding requirements, and to hypothecate corn which is now needed for feed. This is creating a demand for corn which is reducing the excessive terminal stocks somewhat, but the more pronounced effect is the shipping of lightweight hogs and unfinished cattle to slaughter, which signifies a lower consumption of corn.

The A.A.A. corn program has in fact been a race between the attempt to diminish the supply by the acreage reduction plan and to uphold the price by loans, on the one hand, and the various influences operating to reduce corn consumption on the other. These influences include, first, the pig slaughter last Fall, and, second, the maintenance of the corn price at a ratio to livestock prices which made feeding unprofitable, and therefore led to the liquidation of breeding stock, the marketing of lightweight animals and reduction in the number of cattle on feed. Hence the situation is that while the available corn would have gone readily into consumption but for the adjustment measures, a surplus has been artificially created, and while the A.A.A. has had

some success in reducing the surplus of pork, it now has the problem of dealing with the surplus of corn.

All this illustrates the tendency of an artificial solution of one problem to create equivalent problems elsewhere. The situation is unpleasantly reminiscent of the Farm Board's experience in buying up the surplus of wheat and cotton, which resulted in constant disturbance of the markets, and was without effect except to defer the producers' losses from one season to the next by absorbing them temporarily in the Treasury.

Whether a way will be found to handle this stock of corn without depressing the terminal markets is of course impossible to foretell. A sound plan would be to release part of the supply now, and start it into consumption even at the expense of moderately lowering the price. There are abundant reasons for believing that if the sealed stocks are released to local markets in orderly fashion they can be absorbed without great disturbance. Farm stocks on April 1 were lower than in two years, and the poor pasture condition and unfavorable start of all the feed crops increases the requirements for corn.

Hog Prices Lower

All the efforts on behalf of the hog raisers have resulted thus far in little benefit. The average price in Chicago during recent weeks has run from $4 down to $3.50, compared with $4.56, the March peak. At these prices all feeding operations of course are carried on at a loss. During the first five months of the year the farm price of hogs in the Corn Belt was the lowest in relation to the price of corn in the 25 years that records have been kept. As a result the movement of the Fall pig crop to market has been early, and the April slaughter, though smaller than in previous years, showed more than the seasonal increase over March.

However, the outlook for better hog prices is good. In view of the smaller Fall pig crop of 1933 and the early movement referred to, supplies for slaughter during the Summer months will probably be smaller than in 1933. Looking further ahead, the liquidation of breeding stock, and the apparent reduction in the Spring pig crop through the adjustment program, promise smaller supplies next Fall and Winter. Storage holdings of pork May 1 were below average, of lard above.

Whatever the course of the market the purchasing power of the hog raisers will depend upon their profit, and to recover a profitable feeding ratio either hogs must advance by a third or half, or corn decline proportionately. In this situation the commercial hog farmer is obviously dependent upon the A.A.A. benefit payments for his buying power. Disbursement of these payments, which will total $350,000,000 under the corn-hog program, is just beginning. The contracting farmers agree to reduce their corn acreage 20 per cent and their pig crop 25 per cent. However, the intentions to plant report indicates that other farmers, particularly those in the South who have curtailed cotton acreage, have increased their corn plantings, so that the net reduction will be about 10 per cent. Thus the corn States will have a smaller commercial market than usual, while Nature prohibits them from growing their own cotton.

Cattle Adjustment Plan in Preparation

The cattle markets probably will be affected by the drouth, in that an early and heavy movement to market of grass fed cattle will be stimulated. Range conditions have been below average for more than a year, and the drouth makes the situation worse. Hence the outlook is for a movement in volume before mid-Summer, which usually is the heavy marketing season for grass cattle. Unsatisfactory dairy operations likewise promote culling of herds.

On the other hand, the movement of well-finished grain fed cattle is likely to be smaller, since the number on feed in the Corn Belt on April 1 was 12 per cent less than last year. This indicates that spreads will widen between prices of the various grades, whatever the general course of the market may be. Cattle prices advanced from February until the middle of May without an important setback, although the slaughter for the first four months was close to the largest on record, exceeding last year's total by 28 per cent in cattle and 32 in calves. This advance in prices in the face of the heavy movement evidently reflects both increased consumer buying power and a change of preference from pork to beef, in which the processing tax on pork may be a factor.

It is the view of the cattle producers and the A.A.A. officials alike that an adjustment program for cattle is needed, and the effort to devise such a program is now under way, in the face of great practical difficulties. The cattle population has been rising since 1928, having increased from 57,000,000 to more than 67,000,000 or nearly 20 per cent. The number of cows is the largest on record, low prices since 1930 having discouraged slaughter. The calf crop this year apparently is good. Hence the cattle population is likely to increase for another year or two, barring interference, and a sizeable increase in slaughter supplies is in prospect.

However, similar situations have been known in the past, and have righted themselves; and obviously conditions this year

tend to induce liquidation of breeding stock. The "cattle cycle", with numbers increasing for six or seven years and then decreasing for seven or eight, is a familiar one. The cycle is a long one, and the industry relatively inflexible, because two to three years are required to raise a beef steer for market. However, this is a factor inherent in the industry, and it is not clear how any plan short of complete control of breeding can overcome it. But it is plain that any authority which assumes control of breeding will face unparalleled difficulties. It will have to plan three years or more in advance, with due consideration for competing foodstuffs in which production is naturally more flexible; it will have to foresee the effects of its program on the varying interests of breeders, grazers and feeders; it will have to include control of feed crops so that heavy feeding may not offset reduction in numbers; and in addition it will have the usual enforcement and other difficulties of other programs, along with the effect of any processing tax on consumption. According to a ballot being taken by the Drovers' Telegram the cattlemen almost uniformly oppose a processing tax, but this raises questions as to the financing of the plan, and the reaction of the hog raisers.

The argument that it is desirable that the cattle cycle should be smoothed out is one upon which all may agree, just as it is desirable that the business cycle should be smoothed out. But the question is not as to the desirability of the object, but the practicability of the proposals. Even as an emergency plan, it should be noted that a reduction in cow numbers this year would not have the effect of smaller slaughter supplies before 1937.

Dairy and Poultry Outlook

The developments in the feed markets of course affect the dairy and poultry industries. Milk contributes more to both the gross and cash income of American agriculture than any other product, and the share of eggs and chickens combined ordinarily is exceeded only by milk, cotton and hogs; therefore a comment upon the outlook in these industries is in order. Like the hog producers, dairymen and poultrymen are both suffering from relatively high costs of feeds. From 1925 to 1929 one pound of butterfat bought on the average over 30 pounds of mixed grains, but last July the figure was as low as 20.2, in January it dropped to 18.5, and in April it was 23.1. The last figure is but a shade above the pre-war average, and of course all other costs of dairy production are above pre-war.

This ratio is probably too low, if long continued, to sustain milk production. During the grazing season the feed price is less important than in Winter, but mention has already been made of the poor pasture conditions this year. In consequence production of milk per cow is currently the lowest for which records are available, and will continue low unless pasture conditions improve. At the same time the situation promotes reduction in the number of cows in herds, thus pointing the way to bringing the dairy industry back into balance.

The rise in the number of milk cows and heifers has been almost uninterrupted since just after the war, and it will be recalled that the dairy industry was one of the first in which the A.A.A. put forth efforts at production control. However, these efforts have come to failure through the rejection of the proposed plan by the dairymen themselves. There were many reasons for this opposition, including objection to the processing tax, which it was held would either reduce consumption or come out of the producer's price. Regional differences were a great factor, since an average 10 per cent curtailment of output would cause a shortage in the East and South in the season of low production, and require shipments from the West. Moreover, the city milk sheds get a higher price for their butter fat, selling fluid milk, than the butter and cheese producers. For these reasons the production control plan has been laid aside, and the industry will go it alone. Stocks of butter in storage are below average, and with production running at the lowest rate in several years and consumption running ahead of last year the statistical position is in better balance. The seasonal factor, however, is against a price advance.

Prices of eggs, as of hogs and butter fat, have been very low in relation to feed prices during most of the past year, though recently there has been a turn for the better. As poultry operations are quickly responsive to an unfavorable feeding situation, the effects have been discernible in fewer hens on farms, smaller egg production per hen, and smaller hatchings this Spring. Moreover if the ratio is unfavorable through the Summer, more of the hatch will be sold as poultry, fewer pullets held for laying, and existing flocks culled. This will affect egg production in the Fall and Winter. However, present indications are that storage stocks may be large, especially in Middle Western cities. Buying for storage in recent weeks has held prices 25 to 30 per cent above last year. The Department of Agriculture reports that this advance has decreased current consumption, and it may be at the expense of improvement later on.

Complexity of Relations in Agriculture

Space is not available for longer discussion of the animal industries and feed crops, but a showing has been made of the complex rela-

tions that exist among them, of the widening effects that any change in the feed situation has on the feeder industries, and conversely. As long as these relationships are all free to fluctuate they tend to remain as nearly as practicable in balance, and to swing back toward a balance through mutual adjustments when one or other gets out of line, as rapidly as the operations of each industry permit. But when one element in the situation is artificially fixed the readjustments elsewhere are made correspondingly more difficult and severe, and new problems are created. This is the effect of the corn adjustment program on the feeder industries today, while correspondingly the curtailment of feeding interferes with the adjustment of the corn situation.

Little Progress Toward Parity

Agricultural prices as a whole are making little progress toward the parity with non-agricultural prices which it is the Government's aim to restore. We give below figures from the Department of Agriculture on actual farm prices, the so-called "parity" prices as defined in the Adjustment Act, which are the prices necessary to restore the 1909-14 average buying power of one unit of each product, and the percentage of parity. The dates are May 15 last year, when the Adjustment Act was passed, and the same date this year:

	Farm Prices		Parity Prices		% of Parity	
	May 15, 1933	May 15, 1934	May 15, 1933	May 15, 1934	May 15, 1933	May 15, 1934
Cotton ....lb.	$.082	$.110	$.126	$.150	65	73
Corn ....bu	.389	.486	.655	.777	59	63
Wheat ....bu.	.590	.695	.902	1.070	65	65
Potatoes ....bu.	.437	.737	.711	.843	61	87
Hogs ....100 lb.	3.880	3.170	7.360	8.740	53	36
Beef cattle..100 lb.	3.950	4.130	5.310	6.300	74	66
Eggs ....doz.	.118	.133	.167	.198	71	67
Wool ....lb.	.177	.234	.182	.213	97	110

Index Numbers

	May 15, 1933	May 15, 1934	Percent Change
Farm Prices Received..............	62	74	19.4
Prices Paid by Farmers..........	102	121	18.6
Ratio of Prices Received to Prices Paid	61	61	0.0

The first comment upon this table is that only one commodity, wool, has regained its parity position, and it has not had the benefit of an adjustment program. Of the basic commodities in which the A.A.A. has taken a hand, cotton has improved its position somewhat, but wheat and corn have but held their own, and hogs have lost ground.

This table also invites attention not only to the outcome in each market of the attempts to reestablish parity, but to the results on the whole, as presented in the index numbers. In May of last year the index number of farm prices received stood at 62 per cent of the prewar average, and the index of prices paid for commodities bought was 102. The ratio of the two prices (or per cent of "parity") was 61. The latest indexes, for May 15, were 74 and 121, respectively, and the ratio 61, or exactly where it was when the A.A.A. was established.

The A.A.A. has been in operation one year, and plainly it is in order to consider why its results have been so disproportionate to its tremendous efforts and enormous expenditures. It is certain that its difficulties have not been wholly of its own making or even entirely on the side of the farmer, but have come in important degree from outside of agriculture. Rising costs and prices in the industries under the N.R.A. program have been at the expense of the farmer, advancing the prices of everything he buys; and they have placed the A.A.A., as these Letters have many times pointed out, in the position of aiming at goals which are constantly moving higher. Thus the disparity is kept alive.

This is the obvious contradiction of the recovery program. It gives to the effort to reestablish the balance between agriculture and industry the character of a movement around a circle, each pursuing the other, but failing to meet.

The Pending Silver Bill

By the compromise upon silver which the President has effected with the silver party, the former has disposed of two bills, pending in the Senate, which have been a serious menace to the newly-established gold standard. One of these, the Dies bill, originated in the House and passed that body by a large vote, while the other originated in the Senate Committee on Agriculture and received the unanimous endorsement of that body.

The measure agreed to and now pending is similar in character to the Bland-Allison and Sherman enactments of 1878 and 1890, under which the Treasury purchased silver bullion and coined the same into dollar pieces on government account, accompanied by a pledge that gold and silver would be maintained on an interchangeable basis. That legislation ultimately became a grave menace to the stability of the existing gold standard, and was repealed in 1893 for that reason, upon the urgent representations of President Cleveland, who called a special session of Congress for the purpose. The measure now agreed upon involves the same risk, but like the former legislation it is experimental, and its administration, instead of being mandatory, as were the former acts and as the Dies or Senate Committee measure would have been, will be subject to the direction of the President and Secretary of the Treasury, who presumably will desire to follow a policy consistent with that adopted in the Gold Reserve Act of 1934.

The Dies and Senate Bills

In order to understand the President's position it is necessary to know something of the extraordinary measures that have been sidetracked. They combine the idea of subsidizing exports with the idea of raising the price of silver, and avow the ultimate purpose of raising general commodity prices in this country at least to the 1926 level and of raising the market value of silver to the coinage ratio of silver to gold under existing law. It is interesting to note that since the former gold content of the dollar has been reduced by the Gold Reserve Act of January 30, 1934 and the President's proclamation of the following day, while the content of the silver dollar remains unchanged, these bills contemplate a change of the old 16 to 1 ratio to approximately 27 to 1. This notable change in the attitude of the silver party in Congress has escaped general notice.

The plan of the bills was to promote sales of agricultural products for export by offering to receive payment in silver bullion, the latter to be valued in the trade at not less than 10% or more than 25% above the world market price for silver. The silver so acquired was to be taken over by the Treasury in exchange for silver certificates, which would be paid out for the exported products. No limit was placed upon the amount of silver to be so acquired until the world price of silver reached $1.29 per ounce (formerly the 16 to 1 coinage value in gold). The silver certificates were to be full legal tender and all coins and currencies of the United States, including Federal Reserve notes and National bank notes, were to be "redeemable" in silver certificates.

The bills did not stop with the trade proposals. They authorized and *directed* the Secretary of the Treasury to buy not less than 50,000,000 ounces of silver bullion per month, wherever procurable, at a price to be fixed by himself from time to time, all to be paid for by issues of silver certificates of the full legal powers already described.

The Threat to the Gold Standard

Evidently the scope of these bills involved the entire problem of bimetallism threshed over by monetary commissions and international conferences from about 1870 to 1900 without results. No such body ever ventured upon the conclusion that it was within the power of any single nation to establish and maintain a fixed ratio between the values of gold and silver throughout the world, or even in a single country, except by making one metal the standard and cautiously limiting the use of the other. If there is one monetary principle upon which the world has been agreed, it is that if one country, acting alone, shall give the legal tender quality alike and without restriction to both metals at a fixed ratio, the inevitable fluctuations of their value relations in other countries will cause the undervalued metal to move out of the one country and be replaced by the overvalued metal. Opportunity is afforded to bring in the former from outside, exchange it for the latter, take the latter out, and repeat the operation so long as the disparity of values continues. The principle is accepted because it has been verified by the experience of the world, and having proven true when the fluctuations between the metals were small there is no rational basis for doubting that it would prove true with the difference between coinage and market ratios what it is now.

The open market ratio of silver to gold the world over is now about 75 to 1, and if the United States Government should make 27 ounces of silver the legal equivalent in this country of 1 ounce of gold, making both legal tender for the same value, it is reasonable to believe that the world would take us at our word and proceed to trade with us on that basis. We would be obligated to pay gold and receive silver on that basis, releasing gold for export without question or limitation. There are people who will say that the mere announcement of this policy by the United States Government would cause all the people of the world to accept the new valuation and rely implicitly upon it, and we shall not attempt to convince such persons to the contrary. It may be doubted that anybody who possesses any gold would adopt that opinion, and it is almost equally certain that comparatively few who have any silver would have faith in it. There is a universal liking for a sure thing with a speculative possibility, and a person who could trade his silver for gold on the 27 to 1 basis might reasonably feel that silver could not go higher, and that if by any chance the United States should change its policy, he surely would be glad he had taken advantage of the offer. In view of the immunity from risk and the chance of gain, the movement of silver to this country and of gold outward might be expected to be prompt and persistent.

The probable effect of a resulting rise in the price of silver upon mine production is not to be overlooked. When the rapid fall of silver from its former coinage ratio occurred (1870-1900) many silver mines were abandoned, and the production of silver became mainly incidental to the production of the other metals, but this situation might change. This is one of the uncertainties which undoubtedly would be considered the world over.

The Compromise Act

The pending measure, entitled The Silver Purchase Act of 1934, has but one avowed purpose, which is to increase the proportion of

silver to gold in the monetary stock of the United States, "with the ultimate objective of having and maintaining one-fourth of the monetary value of both metals in silver." There is no proposal to change from the gold standard as established by the act of January 30, 1934, but the President in his letter of transmittal treats the new measure as a step toward "concerted action by all nations, or at least a large group of nations," to establish "a permanent measure of value, including both gold and silver," for "a world standard." "To arrive at this point," he says, "we must seek every possibility for world agreement, although it may turn out that this nation will ultimately have to take such independent action on this phase of the matter as its interests require."

The President is carrying out a compromise. He wants to proceed by the orderly method of international cooperation. Presumably he hopes that increased purchases of silver may be gradually made without disturbing the gold standard and that they will support and raise the price of silver in world markets, thus making the international action more feasible.

The provisions for silver purchases appear in Section 3 of the Act as follows:

The Secretary of the Treasury is authorized and directed to purchase silver, at home or abroad, for present or future delivery with any direct obligations, coin, or currency of the United States, authorized by law, or with any funds in the Treasury, not otherwise appropriated, at such rates, at such times and upon such terms and conditions as he may deem reasonable and most advantageous to the public interest: Provided, That no purchases of silver shall be made hereunder (a) at a price in excess of the monetary value thereof or (b) whenever and so long as the monetary value of the stocks of silver is equal to or greater than 25 per centum of the monetary value of the stocks of gold and silver: And provided further, That no purchases of silver situated in the continental United States on May 1, 1934, shall be made hereunder at a price in excess of 50 cents a fine ounce.

The Secretary, acting with the approval of the President, is given full authority to act in his discretion, but he is directed to buy, and the silver group doubtless will urge that some degree of compliance is required.

Apparently the silver is to be purchased at or about the market price from time to time, but not in excess of the coinage value of $1.29, and the amount of silver in the Treasury, reckoned at coinage value, shall always be equal to the amount of certificates outstanding. In the event of the holdings of silver exceeding the 25% ratio, which might result from exports of gold, the Secretary with the approval of the President is authorized to sell the excess, which obviously would require the retirement of certificates of corresponding face value. Silver certificates will be a full legal tender for all debts public and private and are redeemable in silver dollars. No provision appears under which the Treasury would be obligated to redeem silver coin or certificates in gold, but the declaration of the Sherman Act of 1890, that " it is the established policy of the United States to maintain the two metals on a parity with each other" never has been repealed, and the maintenance of parity would be impossible unless they were readily interchangeable.

Here again it may be noted that this bill changes the coinage ratio from the 16 to 1 unswervingly advocated by the champions of silver in the past to the actual ratio of the old silver dollar to the new gold dollar as defined in the President's proclamation of January 31, 1934. The silver certificates are redeemable in "standard silver dollars", which are unchanged from the old content of 371.25 grains of fine silver. The new ratio, as already stated, is approximately 27 ounces of silver to 1 of gold.

The provision for the possible "nationalization" of silver is consistent with the action already taken in regard to the gold, but of little significance, and the other provisions, including the taxation of profits under silver transactions, are matters of detail.

Silver Remains a Credit Currency

It should be clearly understood that under the Gold Reserve Act of 1934 and this act, silver will remain a purely domestic and credit currency as long as the market value of silver is less than the legal tender value of the dollar coin. Hence silver in the Treasury, although nominally an asset, will be a practically unavailable asset. It will not be available in the settlement of international balances, and thus as a connecting link between the monetary systems of this and other countries, and there is no monetary demand for either of the metals except for that purpose. So long as silver is unavailable for this purpose it can be no more effective as monetary reserve than similar holdings of pig iron, copper, wheat or cotton. Any of these commodities would be assets in the sense that they might be sold for money, but the authority to sell silver is limited to sales for the purpose of reducing the Treasury holdings to the 25% ratio, a specific and different purpose; moreover, such sales are not mandatory, and considering that they probably would affect the price of silver unfavorably, which is a matter vitally related to the purpose of the act, it may be questioned whether sales would be made for the purpose of protecting the gold reserves. If not, it follows that the silver in the Treasury will be practically ineffective for the purpose of maintaining the present gold standard, unless and until silver is successfully established in definite relations to gold the world over.

A credit currency—including either token coins, such as our silver money has been

for 100 years, or a paper currency — fully serves the purposes of money in the internal exchanges so long as maintained at fixed relations to the standard money, which is the basis of international transactions, and is convertible into the latter as required for the purpose of making international settlements. Under normal conditions there is no need for conversion on a great scale, and it is a mistake to represent the redemption requirement as involving incalculable demands on the standard money reserves, provided a competent organization, such as the Federal Reserve system, is given adequate control over the total volume of credit in monetary use.

However, our silver dollars or silver certificates in circulation are a charge upon the gold reserve in the same manner as the paper money specifically so redeemable. Possibly this statement needs elaboration, as the point is vital in considering the volume of credit currency: Under normal conditions the stocks of money in the several countries are related to each other in value and quantity, and this is inevitably so, for it is the basis of price-relations. The gold producing countries are able to retain only the proportion of the world's gold stock which their proportion of the world's business requires them to have, the surplus being naturally distributed among other countries according to relative demands. In like manner, any country's use of substitutes for gold inevitably diminishes its holdings of that metal. In other words, if a country is on the gold basis, every increase of credit currency tends to release or expel gold, because gold is the only kind of money acceptable abroad, and the means by which the international equilibrium is temporarily maintained.

It follows that here is where further issues of silver certificates will make themselves felt, as they did under the former silver acts in President Cleveland's time. The gold reserves are larger than at that time, but mere size does not count for so much as the relation of reserves to demands and all attendant circumstances.

The 25-75 Proportion in Metallic Stocks

It must be apparent that whether the ratio of 25 per cent silver to 75 per cent gold in the monetary reserves is a safe ratio or not, depends upon how much other circulating credit of a monetary character there is in the country. In the first place, as we have seen, the silver in the Treasury is not a monetary reserve in the same sense that the gold is, and cannot be unless and until it is acceptable in foreign settlements in a fixed relation to gold. This is not a matter of preference or theory, but a fact so related to business transactions that it must be recognized. In the second place, the entire volume of credit currency, of bank deposits, and of available bank credit, together with all conditions affecting foreign trade and the domestic price level, must be considered as bearing upon possible demands for gold for export. We must take account of the need for means of making settlements in our international relations. Whatever may be said in random talk about the advisability of isolating this country from the rest of the world, there is no reason to think that the present administration at Washington favors any such attempt. But neither in domestic nor international transactions is it possible to do business by two standards of value at the same time. Such an attempt would be even more impracticable than an attempt to use two standards of time, continually fluctuating to each other.

It is true that the international settlements are being made, after a fashion, although the currencies of the world are in disordered relations, but it is sufficient comment to say that the trade of the world in 1933 was only about 32% of what it was in 1929. The basis of international trade is monetary relations, and the most important question about this legislation is its probable effect upon our monetary relations with other countries.

Composition of Our Monetary Stock

Herewith is given a table showing the composition of this country's monetary stock (excepting subsidiary and minor coins) as shown by Treasury statements in each of the years named, down to April 30, 1934, and divided between gold, silver and total credit currencies including silver. To the table a line is added, showing how the April 30 report would be altered by adding sufficient silver dollars or silver certificates to bring the latter up to 25% of the total of silver and gold.

(In Millions of Dollars)

Year June 30 (Except as Indicated)	Gold Coin and Bullion	Silver	All Credit Currency†	Ratio of Gold to All Credit Currency
1880......	352	70	770	45.7
1890......	696	380	1,044	66.7
1900......	1,034	566	1,424	72.6
1910......	1,636	568	2,431	67.3
1920......	2,865	269	5,527	51.8
1930......	4,535	540	4,825	94.0
Jan. 1934*....	4,036	540	6,406	63.0
Apr. 1934*....	7,756	540	6,327	122.6
Apr. 1934‡....	7,756	2,585	8,372	92.6

* Gold in circulation included up to 1930; since January 1934 gold in the Treasury only.

† Excepting subsidiary and minor coin but including silver bullion and gold certificates outstanding. Also including United States notes, National bank notes, Federal Reserve notes of both kinds.

‡ Calculated to show statistical effect of increasing silver up to 25% of total gold and silver reserve, other things being the same.

Note: Reviewing the ratio of gold to the aggregate of credit currencies, it may be said by way of explanation that the rise from 1890 to 1900 reflected heavy importations of gold, after the defeat in 1896 of the

proposal to establish free silver coinage at 16 to 1. From 1900 to 1910 both gold and credit currencies increased, but the latter in greater proportion. From 1910 to 1920 the same was true, the decline of silver reflecting sales of silver dollars under the Pittman act, the increase of credit currency being in Federal Reserve issues. Rise of ratio 1920 to 1930 reflected the extraordinary gold imports of that period and decline of currency in circulation on account of declining business activity. Decline of ratio 1930 to January, 1934, reflected loss of gold and increase of paper money outstanding as a result of hoarding. The rise of ratio from January to April, 1934, reflects the revaluation of the gold stock, which created more dollar units, appearing as nominally of the same value. The ratio figure of the last line is a calculated one, to show what the ratio would be if the contemplated silver addition was made and other figures remained unchanged.

The ratio figures given in the two lines dated April, 1934, are purely provisional, to serve as a guide to the reader in a study of the probable effects of the monetary devaluation accomplished by the Gold Standard Act of 1934, plus the addition of silver currency contemplated by the new act. Before considering these intangible factors, and by way of comparison, it seems appropriate to consider the Treasury and Reserve banks as a central banking institution, similar to all of the central banks of the world, which by a process of evolution have been developed to supply the currencies of the respective countries and to hold the final reserves of the banking systems. Considering the Reserve banks as branches of the Treasury, the reserve deposits should be added to the outstanding currency liabilities, in order to complete the comparison. These deposits at the end of April were $3,993,000,000, which added to the credit currency, $8,372,000,000, gives a total of $12,365,000,000, against which the gold holdings of $7,756,000,000 give a ratio of 62.7%.

We repeat that this is not an actual position, but intended to show the factors in a developing situation. The proposed silver addition has not been made and presumably will not be fully effective for several years. On the other hand, the new gold reserve has not yet produced the effect on the liabilities which it must have. The reserve deposits are larger than normal by reason of increased purchases of government bonds. However, we believe the 62.7 reserve percentage arrived at gives a more accurate idea of the prospective position than either of the April ratios shown in the table.

This ratio compares with recent ratios, similarly arrived at, for the National Bank of the Netherlands 78.9%, the National Bank of Belgium 69%, the Bank of France 78.3%, National Bank of Switzerland 91.5%, National Bank of Italy 47.3.% These are gold standard countries. Owing to the depreciation of the currencies and consequent inflation of currency and deposits, the ratios of the banks off the gold basis are not readily calculated, but making the calculation for the Bank of England at latest date by allowing for the premium on its gold holdings, the reserve of that institution was 58.5%. In all of these cases, however, the reserves apply to an important body of individual and private corporation deposits, while the Federal Reserve banks have practically none of this character.

It appears therefore that the reserve position of the Treasury and Reserve banks combined is not exceptionally strong in comparison with the position of the above named European central institutions performing similar functions.

Two Important Considerations

There are two important considerations to be kept in mind: (1) the proportion of our gold holdings to the total of credit instruments of all kinds circulating in monetary use, and (2) the proportion of our stock of money and monetary credit to the corresponding stocks of other countries. Both have a bearing upon our ability to maintain the present gold reserve. Examining the above table and attached note, it will be seen that the rise of the gold reserves from 1910 to 1930 evidently was abnormal, resulting from the war, and the great trade balance thus created, plus the flight of capital from Europe for security, and finally the speculative attractions of this country during the boom period. Even after the loss from 1930 to January, 1934, the stock was 150% higher than in 1910, which presumably is a greater gain than we would have had under normal business conditions. The rise of gold holdings to 1920, together with the war conditions, resulted in a still greater increase in credit currency outstanding, and a still greater increase of bank deposits in circulation as purchasing power, doing the work of money.

The rise of $3,720,000,000 from January, 1934, to April, 1934, for the most part was a nominal increase resulting from the monetary devaluation, which increased the number of dollar units in the existing gold stock, but approximately $700,000,000 consisted of actual gold (at the new valuation) induced by the circumstances attending the act of devaluation. Evidently this windfall addition has affected the comparability of all the resulting figures. According to our experience in previous years and to the history of money and credit, such an increase of reserve money must in time result in a corresponding increase of outstanding credit currency and bank deposits, but in this case such increase has not yet taken place. The amount of credit currency in circulation was less in April than in January. The act of devaluation was intended to stimulate business, raise prices, put more money into circulation, induce a greater use of credit, and al-

though such changes work out more or less gradually, this should be the eventual effect.

Moreover, the same may be said of the contemplated addition of silver currency, appearing in the last line of the table. The addition has not yet been made and of course the expected effect in an increase of currency, increase of bank deposits and other results have not yet occurred. Inasmuch as this silver currency will be good in bank reserves as the basis of loans and deposits to many times its own amount the aggregate of its influences when fully realized will be very important, although considerably less than that of the newly acquired stock of gold dollars.

Including the gold dollars acquired since January last and silver additions proposed, the total addition to the banking reserves in prospect is $5,765,000,000, or something over 125% from the total of last January.

We are not predicting that the increase of $3,720,000,000 in gold dollars since last January will become effective at an early day, or that the President and Secretary of the Treasury will complete the proposed purchase of silver in the near future, but the gold addition already has been made, and the silver addition is beginning. Even before the pending act was introduced the Treasury was committed to the purchase of this country's silver production, which is about one-eighth of the world production.

Summary of the Foregoing

Our gold holdings have been abnormally increased since 1914 as a result of the war and conditions arising from it, and there is reason to believe that they are disproportionately high in relation to the gold stocks of other countries.

The increase in dollars resulting from the reduction in the gold content of the unit dollar has not yet had the effect upon credit liabilities which it is expected eventually to have, and allowance must be made for this fact. The additions of silver will have similar effects as made and account must be taken of these.

These changes as they gradually occur, and as they must occur if the will to use money and credit is manifested, and if prosperity is to be restored, will mean the employment of the new supplies of money and credit as purchasing power and a consequent rise of prices. This is the intent and logic of the plan and there is no reason to doubt the outcome, although many adjustments in production and prices will have to be made before these conditions can produce the anticipated results.

It is to be considered also that great supplies of money and bank credit have been unemployed throughout the depression and conditions which will enable the newly-created lending power to come into use obviously will take up this slack as well.

Furthermore, the rise of prices naturally resulting from the employment of such an increase of purchasing power may be expected to have a pronounced effect upon our position in foreign trade, the tendency being to increase imports, decrease exports and cause an outflow of gold. If silver purchases are made abroad this tendency will be strengthened.

At present there is so little enterprise or demand for capital anywhere in the world, that the conditions which ordinarily would cause gold to move from the central reserves to the outlying countries for development uses are not effective, but all hopes are that these conditions will change. At present it is impossible to estimate with any certainty what is our normal share of the world's monetary gold. The world has not known normal conditions for twenty years.

Nothing can be more certain than that with a restoration of normal business conditions the world over—and all plans are meant to accomplish this—the normal equilibrium of monetary stocks among countries will tend to be restored. The President, in his monetary message last January, indicated that this probably would mean a redistribution of gold, at the expense of countries now having superabundant supplies. Naturally the more currency we add to our stock the more gold we will be likely to lose.

Effects Upon Our Credit Base

The main purpose of enlarging the proportion of silver in the monetary stock is to broaden the foundations of credit. As we have seen, the present base of our monetary and credit system is gold, and this must be so until silver has a more definite status in the estimation of the world. It is the desire of President Roosevelt to raise silver to an equal status with gold, making them together one standard, but evidently that end will not be promoted by having gold go to a premium over our present stock of credit currency. There is need to strengthen silver in the estimation of the world. The President seeks to do this through an international agreement by which all countries will agree to retain their present silver holdings and to cooperate in absorbing further supplies at an agreed ratio to gold. There is no reason to think that the price of silver in gold would be raised by having the rest of the world sell silver to this country for gold, and while the foundations of credit elsewhere would be strengthened, the foundation under our own credit structure evidently would be weakened.

The President's purpose is not to disturb the present basis, but to strengthen it, and it

is of the utmost importance to the entire recovery program that confidence in this policy shall be maintained. The speculative flurries upon rumors of currency depreciation should mislead no one as to the fundamental necessity for stability in the standard of value. It is agreed that one of the essential conditions of recovery is that capital shall be available for long term loans. An active bond market is wanted. The capital goods industry, which should provide 40 to 50% of industrial employment, has been languishing for four years, on account of lack of demand for such equipment. The need for credit running longer periods than the member banks of the Reserve system can safely grant against their demand deposits is recognized by Congress in the amendment to the Reserve act passed in the last month, authorizing the Reserve banks under special conditions to make direct loans to industrial or commercial business running up to a term of five years. This is a temporary expedient. In any broad sense the capital to finance the business of this country must come from the savings of the people, and their willingness to supply it will depend upon their confidence in the future value of the money. Whatever may be achieved for silver in the future, 27 ounces of the metal cannot at present be regarded as the equivalent of 1 ounce of gold.

It would seem that with so many incalculable elements in the situation, it will be well, so far as possible, to deal with them seriatim rather than by incurring all their liabilities at once; and that we obtain as much world cooperation as possible.

As to Broadening the Base of Credit

The claim that the addition of silver to the world's reserves would broaden the base under the credit structure, implies that legal reserve requirements would be everywhere increased to compel the use of all silver for that purpose; in other words, that the increased supplies of reserve money would be devoted to increasing the safety of the credit structure and not used as the basis for more credit. There is every reason to believe, however, that if the policy of free silver coinage had been adopted by this country in 1896, and the expectations of its advocates had been fully realized by the successful combination of the two metals as a single standard of value—and the credit base thus broadened as desired—the increase of world indebtedness thereafter would have been correspondingly greater than it was, the inflation of prices would have been correspondingly greater and the inevitable collapse would have been correspondingly more disastrous.

A permanent increase of the banking reserves would inevitably involve a corresponding increase in the cost of credit and the charges for it, and if there is no need for it this would be a useless burden on commerce and industry.

We have heretofore pointed to the fact that in the history of the United States down to the outbreak of the War, in only one year did the net imports or exports of gold into or from the United States exceed $100,000,000, so closely does normal trade and intercourse settle itself by the natural offsets. Before the devaluation of the gold unit this country's stock of gold was approximately $4,000,000,000, and the only actual need for gold is for the settlement of the international balances.

The truth is that the world is suffering from the effects of credit inflation, beginning at about 1900 on the basis of an increasing production of gold, aggravated by the war issues of credit, and finished off in this country by the vast increase of bank credit based upon the abnormal importations of gold, which would have been impossible but for the war.

Instead of being chargeable to the gold standard, the inflation and subsequent collapse were clearly results of the war and the reckless expansion of bank credit, for neither of which had the gold standard any responsibility. Both were colossal examples of human fallibility and mismanagement—in the case of banking to the deliberate decentralization of credit control which has been the policy of this country. There is no reason for believing that any monetary or banking system that ever will be devised will be able to provide a stable level of prices through a world war. The innocent naivete with which critics of the gold standard have charged it with all of the aberrations of mankind in the last twenty years has not been equalled since Adam offered his famous defence in the Garden of Eden. There have been no price movements not accounted for by the performances of the human element in prices, and a system of prices which did not reflect violent changes in supply and demand would be like a thermometer that did not reflect changes of temperature.

Our Relations With Asia

It is said with special reference to Asia, that more than one-half of the world's population prefers silver to gold, and that a vast increase of trade with such populations will result from raising the value of their silver hoards to the proposed relation to gold. Also it is said that owing to their preference for silver no movement of the metal from these countries need be anticipated.

It is true that Asia uses silver rather than gold, but the reason is the same as why most people prefer beer to champagne, i. e., because it costs less. The populations of Asia are of

low productive power, and have had to buy the precious metals with other things. They have been able to buy more silver than gold, and in a country where a $5 gold piece represents more than the average month's wage it is obvious that gold would not serve the common uses of money. It is a mistake, however, to think that the masses of Asia have not esteemed gold as a precious metal, and placed about the same relative values upon the two metals as has been current in the western world. There are no keener arbitrage traders in these metals anywhere than the native traders of Asia. India has always been a large importer of gold, but in the last three years has exported gold to approximately $822,000,000 (new) because the price has been relatively high in terms of the Indian currency. There are vast hoards of silver in India, most of it not in the form of coin, and there are plenty of traders alert to an opportunity to trade one metal for the other at home and abroad. The monetary system of India is not based upon silver, but upon British currency, and it is improbable that Indian coin would come to this country as bullion, particularly as the Indian Government in the London silver compact has agreed to certain restrictions upon its sales of coin.

The situation in China is different in that silver is not only the standard of value and basis of paper currencies but the principal means of payment. The falling prices of silver prior to 1929 meant rising prices in China, and surely our silver friends know that this means good times. They do not however grasp the fact that the rise of silver which has been brought about by the agitation to raise silver has caused a grave reaction in prices and business in China. As the result of stagnation in the interior a drift of silver to Shanghai, the principal port and financial center, has caused an increase of stocks in that city as shown by the following figures:

Stocks of Silver in Shanghai
(In millions of ounces)

December,	1930	214
"	1931	191
"	1932	322
"	1933	439
May,	1934	452

India and China have been the great support of silver prices in the past. In the five years ended with 1930 the combined net imports of silver into the two countries averaged approximately 200,000,000 ounces per year, out of a total world production of about 255,000,000 ounces. In each year since, these importations have declined heavily and in 1933 China actually exported 15,000,000 ounces on balance and India imported only 10,000,000, making an export balance for the two countries. Besides private exports the Indian Government sold about 50,000,000 ounces. The Chinese Government has placed a tax of 2½% upon silver exports.

The relations of silver to Chinese internal and external trade were discussed by Mr. K. C. Li, a Chinese engineer, before the Council on Foreign Relations of New York on April 3, 1934, in a highly informative address, from which we take the following extract:

> If the metallic silver is taken away from China, it would mean that she would have no medium of exchange. You gentlemen should understand what a catastrophe that would be.
>
> Assume that only a part of it is taken away from China. It will mean the tightness of money and the tightness of money will mean deflation and depression, and a run on banks the same as you had in March, 1933. China cannot afford to lose much of her silver, just as you cannot afford to lose much of your gold. If you had to go off the gold standard because of heavy withdrawal of gold, would not China have to go off the silver standard if the withdrawal of silver is too heavy? If the United States has suffered from falling internal prices due to an exaggerated value of the dollar, so would China suffer if the external value of her money was increased. If a lower gold dollar is essential to higher commodity price in America, would not a lower silver dollar be necessary if higher commodity prices are to be desired in China?
>
> China does not believe that any legislation for higher gold prices of silver alone will do any good for silver, if not accompanied by higher gold prices in general and by the reduction of unscientific tariffs which prohibit China's exports.

Mr. Li explained that China buys silver with the surplus of her merchandise exports over merchandise imports. The low prices for her exports in foreign markets have caused a reduction of her merchandise imports and last year a complete cessation of silver imports.

Arguments of the silver party are to the effect that raising the price of silver will increase the buying power of China and therefore increase this country's exports to China. Falling prices in China in the last several years have been having precisely the same effect that falling prices have been having in the United States, to-wit, causing losses to all producers and throwing wage-earners out of employment. But the falling prices there are silver, not gold, prices, and have been falling because of the rise of silver engineered in Washington and on the metal exchange in New York.

Apparently there is not the same probability that silver will move from China to the United States that there is of its moving from India or elsewhere, for the Chinese Government probably will take further action, if necessary, to prevent the denudation of the country, but it is a serious blow to the real market position of silver that China has ceased to be an importer; and if silver should be lifted to 27 to 1 and business in China must be adjusted to that basis, it will not be able to import silver until the readjustment is made.

As a measure of relief China may conclude to go to a depreciated paper basis, which would enable her to have any amount of money she wants and at a value to suit, and might provide a gold basis for the paper by selling her silver to the United States if the price continues to rise here.

The Chinese situation is one more complication in the state of world confusion, all of which is unfavorable to orderly steps toward monetary stability.

Effects Upon the Creditor Class

It is perhaps venturesome to say anything about the rights of the creditor class in connection with silver legislation, and yet the very emphasis which is laid upon the need for more liberal supplies of credit, both through the long-term market and the banks, may be taken as evidence that the creditor class has a legitimate function and that it may be well that some vestige of the old thrift habit shall survive.

The action for devaluation has been taken on the theory that it was necessary to restore the price level and enable debtors to meet their fixed obligations. The law is a permanent fact, even though prices are not responding very rapidly, and eventually creditors will doubtless find that their incomes have been devalued as planned. This having been done the creditors presumably have some rights left.

It is a familiar fact that much is being done by means of legislation to preserve the rights of debtors and to afford them permanent relief by scaling down interest charges. Federal appropriations for taking over farm mortgages thus far amount to $2,000,000,000, with another $2,000,000,000 for urban homes, and upon these the creditors accept a substantial reduction in interest rates. It is perhaps not so well known how much more has been done by the voluntary acts of creditors and by private negotiations. According to many reports from trustworthy sources the debtor-creditor situation as between individuals has undergone a great change. The volume of mortgage indebtedness has been reduced, to an important extent no doubt by foreclosures, but while this part is deplorable it is a settled account. There is no reason to depreciate the currency further on that account. Furthermore, the emergency is largely over. Following is an extract from an Iowa man who had heard an address at Des Moines by a representative of the Department of Agriculture. Referring thereto the author says:

> He said that the main problem of the agricultural department was to find some way to scale down the debts that have arisen in conjunction with $400 an acre land in Iowa. Apparently Mr. —— is of the opinion that we are still living back in 1919 and 1920 here in Iowa and still suffering the delusion of high land values which prevailed at that time. As a matter of fact, those fictitious prices for land have long since disappeared through natural processes. Countless individuals and banks have gone broke as a result, but excessive land debts are no more. You can buy a good Iowa farm around here, as a number are doing, for $60 to $100 an acre, land which in 1919 and 1920 would sell for four or five times that. There may be a few exceptions, but I think it is generally true that the land debt problem is a thing of the past. The deflation process has been a terrible ordeal, but it had to happen and it has left this country in a sound basic position. However, all this sacrifice has been in vain if things are to be upset again by the inflationary route, or other dangerous artificial acts.

Of the period of rising land values from 1900 on, the writer says:

> Looking back we can see that many farmers made a comfortable living prior to 1920 by constantly increasing the indebtedness on their farms. I know of a farmer who inherited one hundred sixty acres of land, debt-free. He added to his acreage until he had four hundred acres and wound up with an indebtedness to a defunct bank and on his land of a total of some $60,000. While some of that indebtedness represented capital invested for new land purchased at rather high prices, a good share of the $60,000 was borrowed simply for income purposes. Probably his average annual income for a period of thirty years or so was increased by $1,000 through this borrowing route. And he lived up to the income. During the last year he has made a settlement and is now all clear of indebtedness except a new $12,000 mortgage against his four hundred acres. It was pretty tough on those that loaned the money. While this particular farmer got in deeper than most, yet his case, including the solution, is quite typical.

Such reports as this are enough to put the legislators on notice that the emergency which currency depreciation was intended to meet has been weathered to at least an important extent, before the remedy has become actually effective, and that it is time to give some consideration to what the creditor will have left to live on in the prosperous years to come.

Printed in U.S.A.

in U.S.A.